Wait, see and hope: Explaining crisis management in the framework of liberal intergovernmentalism

von István Benczes

Liberal intergovernmentalism (LI), a state-centric, rationalist-institutionalist paradigm based upon strict microfoundational assumptions, has often been referred to as the baseline theory amongst European integration theories, due to its theoretical soundness, analytical rigour and empirical power[1]. It is rather surprising that in spite of its presumable relevance in providing a sound interpretation of crisis management, LI has not yet been too active in explaining the post-crisis events of the EU – the only exception being Schimmelfennig[2]. In this paper, Schimmelfennig argued that the situation where every party wanted to preserve the single currency by also trying to minimize the costs of crisis management could be best depicted by the so-called "chicken game", a model where the winner takes it all. This paper wants to demonstrate that the "chicken game" might not be an appropriate choice for understanding the actions (and inaction) of member states in the post-crisis situation. It is argued instead that national governments have been engaged more rather in a game of "war-of-attrition".

I. Introduction

Liberal intergovernmentalism (LI) has often been referred to as the baseline theory amongst European integration theories, due to its theoretical soundness, analytical rigour and empirical power[3]. LI is a state-centric, rationalist institutionalist paradigm based upon strict microfoundational assumptions, which in-

1 *Moravcsik, A./Schimmelfennig, F.*: Liberal intergovernmentalism, in: Wiener, A./T. Diez (eds.): European integration theory, Oxford, 2009, 67-88.
2 *Schimmelfennig, F.*: Liberal intergovernmentalism and the euro area crisis, in: Journal of European Public Policy 22/2 (2015), 177-195.
3 Moravcsik, A./Schimmelfennig, F., loc. cit.

ZSE 4/2017, DOI: 10.5771/1610-7780-2017-4-606

terprets integration as a series of rational decisions made by the EU member states. As a grand theory or framework, it consists of three main stages (with each stage utilizing a different set of assumptions and theories): 1) national preference formation (liberal theory of preferences); 2) international bargaining amongst states (intergovernmental theory); and 3) institutional choice (neoliberal institutionalism).

LI was rather successful in explaining the major steps leading towards integration (highlighted by Treaty revisions), but was rather reluctant to explain the crisis management that ensued the recent global financial and economic crisis. There is, however, one exception in the literature: *Schimmelfennig*[4], one of the most influential propagators of LI, elegantly argued that the wish to preserve the single currency (in all Eurozone member states), along with the desire to minimize the costs of adjustment by both the core and the periphery (countries), resulted in a situation that could be best described as a “chicken game”.

This paper does not wish to step outside of the framework defined by LI. Nevertheless, it wants to demonstrate, that the chicken game might not be the most appropriate choice for understanding the actions (and inaction) of member states in the post-crisis situation. It is argued instead that national governments have been engaged in a game of “war-of-attrition”. The phenomenon of war-of-attrition was first adopted in the context of fiscal consolidation by *Alesina* and *Drazen*[5] in a closed economy model and later on by *Fearon*[6] in the context of international relations and institutions. The present paper argues accordingly that EU countries with asymmetrical information about the position of other member states tried to delay agreements in order to occupy a better position in future deals and to traverse the cost of adjustment on others. In turn, the post-crisis era has been characterized by a high degree of uncertainty, inaction and a delay of reforms.

Following a short introduction, Section 2 elaborates on what liberal intergovernmentalism is about, introducing its main concepts and methodology. Section 3 places LI in the context of crisis management and contrasts the “chicken game” model with the war-of-attrition model. Section 4 is a first attempt to describe the EU’s crisis management as a war-of-attrition, while Section 5 is a

4 Schimmelfennig, F., loc. cit.

5 *Alesina, A./Drazen, A.:* Why are stabilizations delayed? in: American Economic Review 81/5 (1991), 1170-1188.

6 *Fearon, J. D.*: Bargaining, enforcement, and international cooperation, in: International Organization 52/2 (1998), 269-305.

more direct application of the theory by rationalizing the first Greek bail-out by the war-of-attrition model. Section 6 concludes the major findings of the paper.

II. European integration and liberal intergovernmentalism

Liberal intergovernmentalism has become a reference point in integration theories due to its theoretical coherence and robust, empirics-based relevance. LI, as a theoretical synthesis or framework, is acclaiming the status of a general social theory, which is not merely a theory of European regional integration.[7] Although LI is admittedly parsimonious, it does not engage in promoting monocausality; instead, it tries to uncover multiple cause-effect relationships[8].

Liberal intergovernmentalism is an unrelenting contender of other major explanations on European integration. It contests the realist claim that European integration would be the ultimate consequence of geopolitics[9]. It also dismisses the federalist view that a unifying Europe would wind up the respective nationalism[10]. LI does not find the explanation of *Milward*[11] too convincing either, as it claims that the integration project was not simply an attempt to save European nation states. Most importantly, it refuses the neofunctionalist understanding of European integration[12] (*Haas* 1958), which concentrates on the intimate relationship between high politics and low politics and emphasizes the (almost sole) importance of supranational elites.[13]

The unit of analysis is the (nation) state and not the EU *per se*. States, however, do not act in a vacuum; they try to articulate their interests through different means, especially interstate bargaining. In European integration, states are the ultimate masters of the treaty. States, being rational, utility-maximising actors,

7 *Moravcsik, A./Schimmelfennig, F.*, loc. cit. As opposed to its main contender, neofunctionalism, which argues that European integration requires an own particular theory.

8 *Moravcsik, A.*: The choice for Europe: Social purpose and state power from Messina to Maastricht, Ithaca/New York, 1998.

9 *Waltz, K.*: Theory of international politics, New York, 1979. *Mearsheimer, J. J.*: Back to the future: Instability in Europe after the cold war, in: International Security 15/1 (1990), 5-56. *Gowa, J.*: Allies, adversaries, and international trade, Princeton/New Jersey, 1994.

10 *Pinder, J.*: European community and nation-state: a case for a neo-federalism? in: International Affairs 62/1 (1986), 41-54.

11 *Milward, A.*: The European rescue of the nation state, Routledge, London, 1992.

12 *Haas, E.*: The uniting of Europe: Political, social, and economic forces, 1950-1957, Stanford, 1958.

13 *Moravcsik, A.*, loc. cit. *Moravcsik* tries to defy neofunctionalism by all possible means. He categorically denies that deepening integration necessarily comes with a constant transfer of sovereignty from national governments to transnational and supranational actors. International cooperation (and European integration in particular) is not driven by modern economic planning or the entrepreneurship of technocratic elites (*Moravcsik, A.*: A new statecraft? Supranational entrepreneurs and international cooperation, in: International Organization 53/2 (1999), 267-306).

base all their decisions on a strict cost-benefit analysis and choose amongst different alternatives accordingly (i. e. cooperating with others or not). Any international agreement or institution is ultimately the output of substantive interstate bargaining. In turn, European integration as such is the result of a series of rational decisions made by self-interested national governments[14].

Nevertheless, LI is not a single theory but a framework. It is a set of mezo-level theories embedded in rational institutionalism. In more concrete terms, liberal intergovernmentalism is a unique combination of three different theories, each reflecting upon a different level (or stage) of analysis. These are: (1) the liberal theory of national preference formation; (2) the intergovernmentalist theory of (interstate) bargaining; and (3) the neoinstitutionalist theory of institutional choice.

Accordingly, LI attempts to provide answers to three distinct questions: (i) How can national preferences be accounted for (as the fundamental motivation for integration – i. e., nations either support or refuse regional cooperation)? (ii) Taking national preferences as given, how can the results of interstate bargaining be explained? (iii) Taking interstate agreement(s) as given, how can governments' decisions be justified for the creation and maintenance of European institutions to which nation states delegate part of their sovereignty?[15]

In accordance with traditional intergovernmentalism, LI assumes that states are unitary actors. However, by adopting the logic of two-level games[16], LI goes far beyond the traditional intergovernmentalist view and assumes that state preferences are the consequences of a national-level preference formation, where domestic actors (interest groups) compete with each other and articulate their own interests. The government's task is to aggregate these often diverging preferences.[17] National governments' room for manoeuvre at the table of international bargains is, therefore, set by domestic actors and their preferences.[18] Thus, Europe-

14 *Moravcsik, A.*, 1998, loc. cit, 3.

15 *Moravcsik, A.*, 1998, loc. cit, 5. In finding the answers, LI concentrates only on major (big) bargains. *Moravcsik* identified five such big episodes in the history of European integration: the Treaty of Rome (1957), the consolidation of the customs union and the CAP in the 1960s, the European Monetary System (1978-79), the Single European Act (1985-86), and the Maastricht Treaty (1991). Although LI tries to explain the interactions and decisions of all member states, *Moravcsik* (1998) concentrated only on three of them, namely Germany, France and the UK.

16 *Bulmer, S./Paterson, W. E.*: Germany as the EU's reluctant hegemon? Of economic strength and political constraints, in: Journal of European Public Policy 20/10 (2013), 1387-1405. *Putnam, R.*: Diplomacy and domestic politics: The logic of two-level games, in: International Organization 42/3 (1988), 427-460.

17 *Moravcsik, A.*: Preferences and power in the European Community: A liberal intergovernmentalist view, in: Journal of Common Market Studies 31/4 (1993), 473-524.

18 Preferences are "ordered and weighted set of values placed on future substantive outcomes, often termed 'states of the world'" (*Moravcsik, A.*, 1998, loc. cit., 24).

an integration cannot be explained without first understanding national preferences.

The next stage is dedicated to the analysis of substantive bargains, and LI basically searches for convergence and divergence in member states' interests.[19] Preferences and state interests are manifold. This is why interstate bargaining lies at the very heart of the analysis of liberal intergovernmentalism. Bargains can be best approximated by the least common multiple[20], each nation sacrificing only as much as is fundamentally necessary.[21]

In the final stage, states decide on how exactly they are willing to commit themselves to an international agreement. In accordance with neoliberal institutionalism, LI takes the position that states renounce part of their sovereignty by creating new institutions (delegation) or by making decisions by qualified majority (pooling), so that each party is able to keep the others under control. Delegation or pooling is the device by which European states can credibly commit themselves to the deepening of European integration. “Governments transfer sovereignty to international institutions where potential joint gains are large, but efforts to secure compliance by foreign governments through decentralized or domestic means are likely to be ineffective”.[22]

III. Chicken game versus war-of-attrition

Liberal intergovernmentalism has often been criticized from many different angles in the last two decades. The (supposedly) too narrow interpretation of economic interest[23] or LI's exclusive focus on the big countries[24] are typical criticisms. According to its opponents, its greatest fault is, however, that *Moravcsik*'s theory is incapable of adequately explaining the changes that evolved in the post-Maastricht era[25]. The EU had to face with and react to a complex set of

19 Preferences are set as given in the second stage.

20 *Moravcsik, A.*, 1993, loc. cit., 501.

21 According to *Moravcsik* (1993 and 1998), decisions in the EU are, by and large, Pareto efficient but they always come with burdensome distributional conflicts. Governments, therefore, apply several techniques such as veto, side payments, threat, etc. during the bargains.

22 *Moravcsik*, in fact, considers the EU itself an international institution acknowledging its unique and complex character, see *Moravcsik, A.*, 1998, loc. cit., 9.

23 *Finke, D.*: Challenges to intergovernmentalism: An empirical analysis of EU Treaty negotiations since Maastricht, in: West European Politics 32/3 (2007), 466-495.

24 *Slapin, J.*: Veto power: Institutional design in the European Union. Michigan, 2011.

25 See among others: *Peterson, J.*: Decision-making in the European Union: Towards a framework for analysis, in: Journal of European Public Policy 2/1 (1995), 69-93. *Tsebelis, G./Garret, G*: The institutional foundations of intergovernmentalism and supranationalism in the European Union, in: International Organization 50/2 (2001), 269-299. *Tsebelis, G./Proksch, S.O.*: The art of political manipulation in the European convention, in: Journal of Common Market Studies 45/1 (2007), 157-186.

exogenous (i. e., globalization and the increasing role of the service sector) and endogenous (especially the launching of the single currency or the Eastern enlargement of the EU) challenges from the early 1990s onwards[26].

Undeniably, LI is most effective in explaining major treaty revisions, and less helpful in rationalizing everyday operation of the EU. Nevertheless, it seems that the global economic and financial crisis that reached Europe in the autumn of 2008 and the consequent sovereign debt crises and their management in particular have definitely brought back LI into the game once again. As opposed to the claims of neofunctionalism or multilevel governance, it seems that European crisis management has been shaped mostly by intergovernmental bargains rather than by supranational elites. Obviously, there has never been a single (European) explanation on what happened and why it happened in 2008-2009; in turn, there is no mutual understanding on what responses the EU should have provided. More importantly, there is no consensus at all on who should take the burden of the post-crisis adjustment. National preferences for crisis management have considerably diverged in the last few years.

Moravcsik and S*chimmelfennig*[27] acknowledge that LI is strong basically in explaining big deals and especially the ones that were struck by unanimity. But they also underline that it was exactly these changes in the post-Maastricht era that provided a solid ground for LI to become once again a powerful explanatory tool. They provide a detailed list of changes that re-valuated LI's position, such as the substantial weakening of the European Commission, which was supposed to represent the interest of supranational elites; or the parallel strengthening of the intergovernmental body of the European Council, which has become the *de facto* agenda setter in the EU. A strong Presidency has also managed to reshape the role of the Council, where informal consensus instead of majority voting is the driving force of decision-making. In fact, informal, consensual decisions outreach economic issues and find a way even to high politics. The rejection of the Constitutional Treaty by the French and the Dutch also provided a clear message that domestic politics in fact tend to dominate the European one implying a "growing drift between increasingly globalised and Europeanised elites on the one hand, and the electorate, or the broader public, on the other"[28].

26 *Majone, G.*: Is the European constitutional settlement really successful and stable? Notre Europe, 2006.
27 Moravcsik, A./Schimmelfennig, F., loc. cit., 74.
28 *Csaba, L.*: The EU at sixty: A watershed or business as usual (Comparing Grexit to Brexit), in: Acta Oeconomica 66/1 (2016), 63-77, 64.

Needless to say, the bail-out of Greece on a strictly bilateral basis in May 2010, the involvement of the IMF in sovereign debt crisis management, or the adoption of intergovernmental treaties such as the Treaty on the European Stability Mechanism or the Treaty on the Stability, Cooperation and Governance of the EMU, two landmark pillars of the post-crisis architecture of the E(M)U, are all evident examples for strengthened intergovernmentalism at the expense of the Community method.

Moravcsik himself has not yet exhaustively reacted to the European sovereign debt crisis. In a recent article, however[29], the author claimed that the disintegration of the Euro-zone was not a real threat because national interests did always converge on keeping the E(M)U alive and together. This widely shared proposition became the starting point of the analysis of another major propagator of LI, *Schimmelfennig*[30], who provided a seemingly solid explanation of the crisis management by applying the framework of LI. According to *Schimmelfennig*, Europe managed to prevent the Euro-zone from a total collapse and even regained the credibility of member states' commitments, but the asymmetric nature of interdependence amongst EMU member counties has given birth to such an institutional design and burden-sharing which exclusively reflected German (and its allies') preferences. The situation is described by *Schimmelfennig* as a "chicken game"[31], referring to hard interstate negotiations and brinkmanship. In this view, the bulk of the adjustment costs was shifted on troubled nations exclusively, which, however, tried to sabotage consolidation.

The preference-ordering of the chicken game is the following: DC > CC > CD > DD, where D refers to defection and C to cooperation (and the first letter refers to the preference of the first actor, while the second letter refers to the second actor's preference).

The chicken game is quite similar to the prisoner's dilemma (PD), as the Pareto optimal outcome (mutual cooperation, CC) is not the equilibrium in any of the two games; yet, CC is strictly preferred to mutual defection (DD).[32] In contrast to the PD, however, the chicken game has multiple equlibria and, in turn, it does not have a dominant strategy.[33] The chicken game is often used in the context of conflictual and violent situations like the Iranian nuclear programme[34] or the

29 *Moravcsik, A.*: Europe after the crisis, in: Foreign Affairs 91/3 (2012), 54-68.
30 Schimmelfennig, F., loc. cit.
31 Schimmelfennig, F., loc. cit.
32 Preference ordering of the PD: DC > CC > DD > CD.
33 The Nash equilibrium of PD is DD.
34 *Sadjadpour, K.*: The nuclear players, in: Journal of International Affairs 60/2 (2007), 125-134.

invasion of Iraq by the US. The Arabic-Israeli conflict or Russia's aggression against the Ukraine is also a typical example for chicken games in the literature. Some of the trade negotiations, especially when one party has to take unilateral concessions, can be described by a chicken game, too[35].

Schimmelfennig[36] provided a couple of points for demonstrating the rightness of the chicken game analogy. First, each and every country tried to avoid the worst outcome, i. e., the disintegration of the EMU (DD). Keeping the single currency alive and introducing reforms (CC) was strictly preferred to the collapse of EMU, because each participant could only gain with the Euro. Second, the chicken game – in harmony with LI – has a distributional conflict, too: actors must agree on how the burdens of crisis management are distributed. The highest payoffs (DC) can only be reached if one actor can force the other one to take the costs. The other one loses but is still alive; that is, it can remain in the EMU (CD).[37] Third, the chicken game is also adequately descriptive with regard to actors' irrationality, which *Schimmelfennig* addressed as brinkmanship. That is, actors try to send signals that they lost control over events in order to deter others.

While the chicken game could be a good starting point in explaining crisis management by revealing diverging preferences on outcome, it might not be the most appropriate choice for understanding the actions, and more importantly the lack of actions, of member states in the post-crisis situation. It is argued here, instead, that national governments have been steadily engaged in a game of "war-of-attrition".

"War-of-attrition" is often called the "game of timing", as it has two major defining characteristics: (1) the winner's payoff is greater than the loser's payoff; and more importantly, (2) payoffs do deteriorate as time passes. While the first characteristic is obvious, the second one can partly address what *Schimmelfennig* labelled as brinkmanship[38] since actors choose to wait instead of acting even if their reluctance to act implies a significant decline in payoffs. Waiting (insisting on the status quo) is basically the consequence of informational asymmetry amongst partners: actors are well-informed about their own stakes but are una-

35 *Aggarwal, V. K./C. Dupont*: Collaboration and co-ordination in the global political economy, in: Ravenhill, J. (ed.): Global political economy, Oxford, 2008, 67-94.

36 Schimmelfennig, F., loc. cit.

37 This second argument is similar to *Grubers* neorealist proposition, which tried to demonstrate that regional cooperations do not always rest upon mutual benefits. The main motivation for joining an agreement is often the fear that the winning coalition would go ahead without the loser. His point was illustrated with the EMS among others, see *Gruber, L.*: Ruling the world: Power politics and the rise of supranational institutions, Princeton, 2000.

38 Schimmelfennig, F., loc. cit.

ware of other parties' payoffs. If actors opt to wait, the question for them is how long it is worth waiting for (and thus foregoing the benefits of an immediate action) in order to win the game and force the other party to take all the costs. This approach is therefore rather useful in cases where the task is to reveal different bargaining strategies over time when the status quo deteriorates.

As the model is best applied to situations of waiting (such as political stalemates or the delay of efficiency-enhancing reforms), it has been adopted in a wide variety of situations. *Eichengreen* and *Temin*[39], lamenting on the unfeasibility of the gold standard in the 1920s, tried to explain events during the interwar period by referring to war of attrition. *Fidrmuc*[40] and *Frye*[41] discussed the possible implications of war of attrition on economic reform and economic growth in the context of transition economies.[42] *Zadra*[43] or *Schweller*[44] applied it to European security dilemmas by comparing war of attrition to a blitzkrieg.[45] Terrorism and global war was in the focus of *Jadri*[46].

In a more explicit discussion of war of attrition, *Alesina* and *Drazen*[47] observed that coalition governments react only slowly or not at all to fiscal shocks, so stabilization is delayed, thereby placing extra burden/costs on society. While stabilization would socially be the optimal outcome, coalition partners insist on the status quo (no reform) because they are unable to agree on the distribution of costs of fiscal consolidation amongst themselves – assuming that different coalition parties represent different constituencies and their interests. In lieu of a be-

39 *Eichengreen, B./Temin, P.*: Fetters of gold and paper, in: Oxford Review of Economic Policy 26/3 (2010), 370-384.

40 *Fidrmuc, J.*: Economic reform, growth and democracy during post-communist transition, CEPR Working Paper No. 372, London, 2001.

41 *Frye, T.*: The perils of polarization: Economic performance in the post-communist world, in: World Politics 54/3 (2002), 308-337.

42 *Frye*, for instance, applied the model explicitly in order to test the relevance of political struggle between two factions in post-communist economies, i. e., the ex-communists and the anti-communists, and found that a fierce battle between the two camps had a statistically significant and negative impact on economic growth, see *Frye, T.*, loc. cit.

43 *Zadra, R.*: European integration and nuclear deterrence after the Cold War, Challiot Papers No. 5, Institute for Security Studies, Paris, 1992.

44 *Schweller, R. L.*: Tripolarity and the Second World War, in: International Studies Quarterly 37/1 (1993), 73-103.

45 *Schweller* identified war-of-attrition situations in two different "fronts" in World War II. On the one hand, *Stalin* hoped to induce a war of attrition amongst Western capitalist countries by signing the non-agression pact with Germany, while Russia could easily gain strength and annex Eastern Europe. On the other hand, the potential threat of a war of attrition between Germany and the UK (allied by the US) forced *Hitler* to change his plans and turn against Russia in 1940 with the hope that a defeated Russia would make it much easier to bring the British to heels later on, too. See *Schweller, R. L.*, loc. cit.

46 *Jadri, V.*: War, security and the liberal state, in: Security Dialogue 37/1 (2006), 47-64.

47 Alesina, A./Drazen, A., loc. cit.

nevolent social planner, no party is ready to take the costs without (some) fight. Fiscal consolidation therefore takes place only if additional waiting is counterproductive – for at least one of the parties. In technical terms, fiscal consolidation is initiated only when the marginal benefit of (extra) waiting equals its marginal cost.

Fearon[48] adopted the model of war of attrition in the context of international relations with the aim of demonstrating that states would bargain heavily or even delay the agreement in order to take a better position in the future and lock themselves in an agreement with better conditions. In his model, both states want to reach an agreement (lack of agreement is the worst outcome), but the two actors cannot agree on which of two different drafts they should adopt as each draft delivers higher net benefits to one of the parties. In more general terms, "there will almost invariably be *many* possible ways of writing the treaty or agreement that defines the terms of cooperation, and the states involved will surely have conflicting preferences over some sub-set of these various possibilities"[49]. Since there is no superior authority over states in anarchy, states do wait and try to make the other party yield. But waiting has its certain costs: (1) foregone benefits of possible cooperation, and (2) an increasing risk that one of the parties will totally decline the agreement and will try to negotiate another agreement with other parties (for instance quitting a multilateral trade agreement and joining a regional integration).[50]

IV. The EU's crisis management

The European crisis management split the Euro-zone member states, by and large, into two distinctive groups. The crisis-hit economies, often called the periphery or the PIIGS, referring to Portugal, Ireland, Italy, Greece and Spain on the one hand and the Northern or core economies (Germany, the Netherlands, Luxembourg, Finland in particular) on the other hand. Needless to say, the two groups are far from being homogenous, as serious differences exist among the respective members as well.

48 *Fearon, J. D.*: Bargaining, enforcement, and international cooperation, in: International Organization 52/2 (1998), 269-305.

49 *Fearon, J. D.*, loc. cit., 274.

50 *Fearon* had another main proposition. It argued that the bargaining stage (that may culminate in the adoption of an international agreement or institution) and the enforcement stage (following the adoption of the agreement) are two distinctive phases which require different approaches in understanding them. Prisoner dilemma and iterated PD (tit-for-tat strategy) is a good approximation of the situation of enforcement but coordination games such as the war-of-attrition model are the right depiction of the bargaining phase. See *Fearon, J. D.*, loc. cit.

When the global financial crisis culminated in a full-fledged sovereign debt crisis in 2010, the PIIGS had the following three options: (a) leave the Euro-zone and return to the national currency, (b) announce a default on sovereign debt, or (c) apply for financial rescue. However, in principle, none of the three options was applicable to these economies. The whole Maastricht project was based upon the explicit or implicit acknowledgement of a triple denial, that is, the denial of bail-out, default and exit[51].

The crisis-hit economies never really wanted to abandon the single currency and return to their national currencies. An exit would have practically resulted in a devastating effect on the troubled nations, since the public debt would have (still) been denominated in Euro, whereas all (future) income would have been accrued in national currencies[52]. In fact, any country that decides to leave the EMU should, in principle, decline its EU-membership, too, which makes such a scenario rather unlikely. Nevertheless, exit and especially the threat of an exit can substantially strengthen the bargaining position of the periphery, because an exit can significantly endanger the stability of the Euro-zone. The chicken game might be a fitting depiction of this scenario: exit (DD) being the worst case outcome in any sense.[53] DC in the chicken game, on the other hand, is the most preferred outcome of the troubled nations (threatening with exit and forcing others to yield), which, however, evidently generates moral hazard in a currency union.

Default has never been a desired option either, as it always entails a huge economic and social burden. Also, a default may undermine the stability of the whole currency area, as other countries may also become the target of speculative attacks of international financial markets. Not only was exit unmentioned in the TFEU, but default as well was considered as an unrealistic scenario. Consequently, no mechanisms or procedures were elaborated on by the EU in case of such a situation. In turn, countries could have chosen only disorderly default in case of ominous trouble, pushing the whole Euro-zone to the brink. Accordingly, default and especially threatening others with a disorderly default might be well captured by the chicken game, too.

Nevertheless, as it was claimed earlier, both the core and the periphery agreed on the priority of maintaining the stability of the Euro-zone as the Pareto-optimal

51 *Benczes, I.*: The impossible trinity of denial, in: Transylvanian Review of Administrative Sciences 9/39 (2013), 5-21.

52 *Eichengreen, B.*: The breakup of the euro area, NBER Working Paper No. 13393, Washington DC, 2007.

53 The first letter referring to the troubled nation's choice, the second one to the core.

solution[54]. None of the EMU countries has ever speculated seriously about these two extreme possibilities. The chicken game, therefore, could never be an appropriate description of the crisis management situation in the EU.

Since neither exit, nor a (disorderly) default were ever considered as a realistic option, only the third case, financial assistance, remained on the menu. No doubt, any financial rescue has serious distributional consequences. Yet, this option still seemed to be the least painful and most reasonable cooperative solution. There was one thing in common in the two groups under investigation: they both wanted to return to normalcy, and – in harmony with LI's propositions – it seemed that the least common denominator upon which governments' preferences did converge was the idea of a financial rescue. Financial assistance was hoped to be the possible means of minimizing the costs of crisis management on both sides.

The ultimate question, therefore, boiled down to the following: When and under what terms and conditions could a deal be struck between the two groups? Such a situation is best characterized by the war-of-attrition model. A too long wait can have evidently high costs for both sides, as both the troubled individual nation state and the Euro-zone as a whole would lose increasingly more as time went by. But minimizing the costs (and winning the game) also means that actors try to choose their time of effective waiting, so that their net benefit is positive or at least non-negative.

At the periphery, countries evidently tried to minimize the cost of crisis management and to shift as much of the burden of crisis management as possible onto the core. Practically they wanted two things: 1) the core taxpayers to pay the bill, and, more importantly, 2) to commit themselves to reforms which would be as soft as possible due to the associated political and social consequences of any consolidation that would imply a change in the prevailing *status quo*. At first glance, it might be trivial to assume that the troubled nations did not have too much to offer for the others; therefore, the core could easily enforce its terms and conditions on the crisis-hit economies. But this was not necessarily the case. First, as it was shown earlier, troubled nations can always threat others with exit or default, thereby destabilizing the whole Euro-zone. Second, strict conditionalities attached to financial rescue can always be softened by referring to "unexpected circumstances". Implementing only partial reforms is always a possible and rational strategy in a waiting game. Third, PIIGS have had an immense interest in allying with the European Commission in its attempt to mutualize public

54 See especially *Moravcsik, A.*, 2012, loc. cit., 54-68 and *Schimmelfennig, F.*, loc. cit.

debt. The common issuance of sovereign bonds was, in fact, a clear supranational solution of crisis management, proposed by the European Commission (2011)[55] and backed by France under *Sarkozy*; yet Germany never gave credit to a Euro-bond due to the assumed endorsement of a moral hazard. Nevertheless, the very idea of debt mutualization, a much-refuted option by the Germans was (or could have been) a card in the hands of the periphery, too.

Core countries also tried to minimize costs during crisis management. The core had to solve a puzzle, though. A financial rescue is an explicit violation of the so-called no-bail-out-clause of TFEU (Article 125,1),[56] which says that no member state or the EU itself can rescue another country. The no-bail-out clause was placed in the Treaty for a very good reason. It was rightly assumed that financial rescue could strengthen moral hazard in a currency union, making countries less reluctant to claim special status at times of difficulties. Abandoning the article had certain costs in terms of weakened credibility (a point that the core has always tried to avoid). The solution to such a dilemma was to grant the first Greek bailout package upon the assumption of "extraordinary circumstances" that were beyond the control of the Greek authorities (Council regulation 96/06/2010).[57] More importantly, strict conditionalities were attached to the rescue plan. Besides these, half year later, a three-pillar-rescue mechanism (EFSF, EFSM and IMF) was established on a temporary basis in order to institutionalize official rescue.

Financial assistance, in turn, was provided on the basis of strict conditionalities. Core countries wanted to strongly commit crisis-hit economies to crisis management. The core also wanted to engage the periphery in taking as much fiscal consolidation and economic reform as possible. Nevertheless, the core had to be somewhat cautious about its demands with regard to fiscal, financial and structural reforms. If the cost of reform was politically or even economically untenable, thereby alienating the periphery, the whole situation could have eventually deteriorated into default or a total abandonment of EMU membership. In this sense, partial reforms are better than no reforms at all and much better than a country's collapse or a possible collapse of the whole Euro-zone.

Amongst the core countries, Germany has evidently taken the leadership position

55 *European Commission*: Green Paper on the feasibility of introducing stability bonds, COM (2011) 818. Brussels, 23 November 2011.

56 *TFEU*: Consolidated Version of the Treaty on the Functioning of the European Union, Official Journal of the European Union C 115, 9 May 2008.

57 *European Commission*, 2010, loc. cit.

in crisis management. But why was Germany, an all-time propagator of multilateralism and European integration in particular, reluctant to commit itself to a wide-scale rescue by using its taxpayers' resources right from the beginning of the crisis?

Following the German unification, Germany became the strongest player in the European arena. Nevertheless, it never really acted (or even imitated to act) as a hegemon. Germany remained the strongest supporter of integration in the post-Maastricht era, always ready to pay the bill of deepening or enlarging the EU. Yet it always let France and/or the European Commission take the leading role in the design of the integration process. The crisis, however, has brought about significant changes to the European landscape. France has become weak both in economic and political terms following the crisis, especially under the presidency of *Hollande*. The UK, not being part of the Euro-zone, soon maintained its distance from crisis management and started to concentrate solely on its own economic troubles. The European Commission under *Barroso* did not seem to be willing to become the agenda setter either[58]. Applying the vocabulary of LI (and neoliberal institutionalism), the asymmetric nature of interdependence has dramatically increased in the EU, finding Germany in a rather new and unusual position of a "reluctant hegemon", a position that was more rather the consequence of circumstances than intention.[59] Paradoxically, Germany should have provided stability financed by German resources (as it normally happens under a hegemon) when domestic politics shifted away from unconditional support to European integration. National preferences in Germany, by and large, have become seriously anti-bail out or even anti-Greek.[60]

58 *Wyplosz, C.*: Happy 2012?, http://voxeu.org.

59 *Bulmer, S./Paterson, W. E.*, loc. cit., 1387-1405. According to *Kindleberger*'s hegemonic stability theory, leadership can be provided either "consciously or unconsciously [by a country], under some system of rules that is has internalized, to set standards of conduct for other countries", see *Kindleberger, C.*: The world in depression, 1929-1939, University of California Press, Berkeley, 1973, 28.

60 *Schweiger, C.*: The reluctant hegemon: Germany in the EU's post-crisis constellation, in: Demetriou, K. (ed.): The European Union in crisis: Explorations in representation and democratic legitimacy, Wiebaden, 2015, 15-32. Germany survived the crisis relatively unscathed. But the relative German success did not come without a price. *Gerhard Schröder*'s cabinet launched a wide-scale labour market reform, which made the German economy competitive enough for it to erase the former negative epithet, the "sick man of Europe" (*Dustman* et al. 2014). Most surprisingly, while the 2008-2009 crisis saw EU member states lose out on employment, Germany in fact managed to substantially reduce its unemployment rate to 5.2 % by 2013, the year when the EU average unemployment rate was at its maximum, see *Benczes, I./Szent-Iványi, B.*: Rising hopes in the European economy amidst global uncertainties, in: Journal of Common Market Studies 54/1 (2016), 167-184).

V. The case of the first Greek bail-out package

The report of the European Commission[61] in 2008 celebrated the success of the Euro-zone by claiming that the single currency had greatly contributed to the spectacular growth performance of countries such as Spain or Greece. And indeed, the average annual growth rate of the Greek economy was twice as high as the Euro-zone average (4 % versus 2 %) between 2000 and 2009. Greece did approximate the EU average (on PPP) at a quite remarkable pace, reaching almost 90 % of the Euro-zone average GDP-level (starting the catching up at 75 %). The drivers for growth were, however, ill-fated. The Greek economy was revved up by a dramatic increase of internal demand (especially consumption and housing), boosted by the inflow of capital from the core members of the EU. With the benefit of hindsight, capital flows to the periphery did not finance the build-up of those competitive export capacities that could have guaranteed the repayment of foreign sources. The massive inflow instead fed the acceleration of the non-tradable sectors in the periphery, including Greece. The so-much awaited convergence was, in fact, only an illusion.[62]

What made Greece different from other countries in the Euro-zone, and from the crisis-hit economies in particular, was its perversely relaxed fiscal policy, which constantly violated the Stability and Growth Pact. The size of redistribution climbed from the initial 44 % in 2000 to 54 % (!) by the time of the eruption of the Greek crisis. Several causes could be named: overestimation of tax revenues and a wide-scale tax evasion on the revenue side; the radical increase of the compensation of public sector employees (2000: 10.5 %, 2009: 13.1 %)[63] and the increase of social benefits (21.3 % in 2000, 28.4 % in 2009) on the expenditure side.[64]

61 *European Commission*: EMU @ 10: Successes and challenges after ten years of Economic and Monetary Union, European Economy 2, Luxembourg: Office for Official Publications of the European Communities, 2008.

62 At the time of the creation of the EMU, there were simply no concerns over the perverse effects of persistent external imbalances. In fact, unidirectional capital flows were supposed to strengthen the convergence process of the latter. Financial and economic integration was not simply a means in order to enhance more effective resource allocation, but was also a process that could highly contribute to the synchronization of business cycles – a thesis that was highly endorsed by the endogenous theory of optimum currency areas, see *Mongelli, F. P.*: European economic and monetary integration, and the optimum currency area theory, European Economy – Economic Papers No. 302, Brussels, 2008.

63 Due to the massive increase of real GDP, such an increase in the compensation of public sector employees meant in fact a doubling in Euro terms, from 15,902 bn to 31,06 bn. 2010 was the first year in a long row when (nominal) wages declined in the economy.

64 According to different estimates, REER appreciated by 10 to 20 % in Greece during these years. See *European Commission*, 2010, loc. cit.

Table 1: External balance and the general government in Greece

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Current account						-8.3	-10.5	-12.5	-12.6	-9.8
Net external debt				47.9	51.0	57.2	60.1	66.1	73.2	84.2
Total expenditure, general government	46.4	46	45.8	46.6	47.6	45.6	45.1	47.1	50.8	54.1
Balance, general government	-4.1	-5.5	-6.0	-7.8	-8.8	-6.2	-5.9	-6.7	-10.2	-15.1
Primary balance, general government	2.8	0.8	-0.5	-2.9	-4.0	-1.5	-1.5	-2.2	-5.4	-10.1
Public debt	104.9	107.1	104.9	101.5	102.9	107.4	103.6	103.1	109.4	126.7

Source: AMECO and Eurostat

In November 2004, the Greek cabinet admitted for the first time that the country actively manipulated the books of the general government with the aim of qualifying Greece into the Euro-zone. It was, however, five years later when all the domestic economic troubles, along with a series of mismanagement of public data, were made public by the incoming left-wing *Papandreou* government. The prime minister acknowledged in public that the Greek economy was "in intensive care... This is without doubt the worst economic crisis since the restoration of democracy [in 1974]."[65]. In turn, his finance minister announced that the cabinet would do "whatever is required" to put public finances back on track[66]. With the immediate announcement of a consolidation package, the cabinet hoped to buy time and acquire the support of international financial markets. Markets, however, reacted differently. *Fitch Ratings* downgraded the Greek sovereign debt to BBB+ (with a negative outlook) on December 8th, 2009, which was the lowest rating that a member state in the Euro-zone had ever received.[67] In his reaction, the prime minister demonstrated strong commitment to reforms in his televised appearance: "It is time to address and resolve, once and for all, deep-

65 *The Guardian*, November 30th, 2009.
66 *FT*, December 8th, 2009.
67 Before the crisis, the ECB – in principle – did not accept sovereign bonds in its transactions at such a low rate. Needless to say, this was only a hypothetical declaration, since no Euro-zone country was ever deprived from its prime (A-rated) status. The crisis, however, altered the conditions and the ECB discarded its hypothetical pre-crisis rule.

rooted problems that are holding the nation back"[68]. In a few days, however, other rating agencies downgraded the country's sovereign debt, too. By the end of 2009, mass demonstrations erupted on the streets of Athens. Nevertheless, at this point Greece still seemed to warrant for its liabilities and there were no signals yet from either side to involve the EU itself in the crisis resolution.

The situation quickly changed, however. By early February 2010, *Papandreou* warned about the wider consequences of a possible Greek default, saying that "Greece is at the centre of a wider speculative game which even has the Euro as its target"[69], but still did not ask the help of the EU. During the next EU summit, in the middle of February 2010, the EU finally reacted officially to the Greek situation. The summit provided only mixed signals; no concrete measures were agreed upon by member states. While all parties agreed on the need to preserve the stability of the Euro-zone, the national interests overtly diverged on how stability should be guaranteed. The final statement of the summit placed all the burden of returning to normalcy on Greece itself and underlined that the "Greek government has not requested any financial support"[70].

Angela Merkel, under pressure from domestic politics, refused any concrete financial support to Greece.[71] The German view (backed by *Jean-Claude Trichet*, the governor of the ECB at the time) was clear: Greece had to fix the problem on its own, otherwise the credibility of the whole currency area would be undermined – a strong signal that the EU would not violate its no bail-out clause. France and Spain, on the other hand, urged common actions on behalf of Greece. "The European strategy that emerged...was one of wait, see and hope"[72]. A waiting game unfolded, where all the parties tried to avoid a potential collapse – but no one was ready yet to take the burden.

As the Greek conditions deteriorated and the threat of contagion did not evaporate either, the E(M)U leaders hammered out a Greek bail-out package worth 30bn on April 11th, 2010. The Greek prime minister celebrated the safety net as a

68 *The Guardian*, December 14th, 2009.
69 *The Guardian*, February 2nd, 2010.
70 *European Commission*, 2010, loc. cit.
71 Domestic politics had at least two dimensions. First, the most populous state, North Rhine-Westphalia held Landtag elections on May 9th, which was considered as a test of the popularity of the federal government. In mid-February, the German cabinet believed that Greece could finance itself until mid-May, and actions would have been required only after the elections, see *Münchau, W.*: Germany pays for Merkel's miscalculations, Financial Times, May 10th, 2010. Second, domestic politics did not equate with party competition for prospective votes exclusively. The German Constitutional Court has become a heavyweight actor in shaping Germany's Europe politics, see *Bulmer, S./Paterson, W. E.*, loc. cit.
72 *The Guardian*, February 11th, 2010.

means by which the Euro-zone member states finally became involved in the game: "With today's decision, Europe sends a very clear message that no one, any longer, can play with *our* common currency, no one can play with *our* common fate"[73]. At that point, each player thought that there would be no direct need to activate the rescue package; Greece could instead tap the financing pools of international markets.

But sovereign bond yields dramatically increased and Greece drifted to the brink quicker than what anyone expected. Finally, the country had officially to ask for a 45bn rescue on April 22nd, 2010 in order to avoid the unchartered territory of default. Importantly, the country itself did not publicly lament on default (just the opposite occurred: it tried to avoid it by all means); it did not speculate about a return to a national currency, either. The *Papandreou* government seemed to understand the severity of the problems and did not associate itself with brinkmanship (DC was supposedly not preferred to CC – Greece being the first player). At that point, the Greek government could, in fact, engage in a sort of chicken game, but it did not do so, as the country had too much to lose. The cooperative outcome, i. e., an official rescue, seemed to be the only way out of the situation (as CC was strictly preferred to DD). The question was therefore under what conditions the EU would be ready to throw a lifebelt to the troubled nation. And the EU did not seem to be willing to pay for nothing. The IMF was invited to the table as *Merkel* hoped that a presumably depoliticized and highly technocratic institution such as the IMF was much better equipped with the necessary skills and capacity than the EU itself.[74] In consequence, the bail-out was offered at the expense of tough economic and financial reforms (termed as "conditionalities"). For *Merkel*, the primary aim was not rescuing Greece itself but to keep the Euro-zone intact: "If Greece is ready accept tough measures, not just in one year but over several years, then we have a good chance to secure the stability of the Euro for us all"[75].

If the Greek situation had something to do with the chicken game, it was most likely felt during these days (April 22nd-May 2nd), thanks to the apparently relentless behaviour of Germany. It was hoped that this toughness would be interpreted as Germany's firm position (i. e., that it offered only a conditional "yes" to a

73 *The Guardian*, April 11th, 2010 – italics added.

74 Which in fact could also be interpreted as a serious German mistrust in the E(M)U institutions themselves, see *Morisse-Schilbach, M.*: "Ach Deutschland!" Greece, the euro crisis, and the costs and benefits of being a benign hegemon, in: Internationale Politik und Gesellschaft 14/1 (2011), 28-41).

75 *FT*, April 26th, 2010.

bail-out package[76]), but international financial markets encoded it as an indecisiveness of the EU. National preferences and domestic politics made Germany unaware of the EU-wide consequences of its position. In turn, *S&P* downgraded the Greek sovereign debt into junk status and envisaged the downgrading of Portugal, too (on April 27th). A day later *Angela Merkel* acknowledged that it was a politically motivated and wrong decision to allow Greece to join the Euro-zone.[77] In sum, the mixed signals that came about as a result of the predominance of domestic politics and national interests over the interest of the community, along with inaction and delay, did result in some sort of brinkmanship, which drove up yields and pushed Greece to the edge of a total collapse.[78]

The final decision on May 2nd provided Greece with a bail-out package of 110 bn Euros for three years. The agreement was based on bilateral loans coordinated by the European Commission (80 bn) along with the IMF (30 bn). The price of the package was substantial in terms of the expected reforms. The bail-out was provided on the ground that Greece would manage to meet three conditions: (1) in the short term, a quick restoration of trust by adopting an immediate start of fiscal consolidation and bank resolutions; (2) in the medium term, the enhancement of competitiveness by endorsing wide-scale structural reforms (especially in the state-run sector); (3) in the long term, regaining Greece's credibility on the financial markets.[79]

The comprehensive package had very different interpretations. The Germans emphasised the strict policy conditionalities and insisted on their one-off character. The EU communicated the need to defend the Euro-zone and also tried to

76 "Germany will help if the appropriate conditions are met" – *Merkel* (*FT*, April 26th, 2010).

77 *Meiers* characterized Germany's crisis management between late 2009 and March 2010 as a laissez-faire policy that was followed by a "reactive step-by-step engagement marked by Berlin's insistence of a quid pro quo of solidity in return for solidarity", see *Meiers, F-J.*: Germany's role in the euro crisis: Berlin's quest for a more perfect monetary union, London, 2015, 6. However, *Jones* called *Angela Merkel*'s policy (and attitude) to Greece simply a "folly", due to her reluctance to intervene in time. *Jones* actually put the blame on the German chancellor for the contagion itself. See *Jones, E.*: Merkel's folly, in: Survival 52/3 (2010), 21-38

78 Importantly, this is not a normative statement; it has been drawn as a conclusion from the propositions of LI.

79 *European Commission*, 2010, loc. cit. Greece was expected to stabilize its debt-to-GDP ratio by reducing the deficit below 3 % and pushing up the primary balance to plus 6 % by the end of 2014. The current account deficit could not be more than 2 to 3 %, and the net external debt should decline by 2013. Fiscal consolidation targeted primarily the expenditure side. Particular attention was dedicated to the public sector wages and pension payments, since these two items had grown dynamically before the crisis, reaching three-fourths of the total outlays. Seasonal bonuses and 13th- and 14th-month salaries were taken away. The retirement age was raised to 65 years; early retirement was financially penalized. On the revenue side, VAT increases were planned, along with the strengthening of the progressiveness of the personal income tax system. Greece also aimed to improve the effectiveness of the tax administration, along with a fight against corruption and tax evasion.

sell the package as a non-violating act of the no-bail out clause. The Greek cabinet, on the other hand, tried to frame Greece as a victim of circumstances, where the stake was the stability of the whole Euro-zone but the price had to be paid basically by the Greeks.[80]

VI. Conclusion

Domestic politics and interstate bargaining have perhaps never been so determining in European politics than in the post-crisis era. Liberal intergovernmentalsim, a state-centric, rational institutionalist approach to (European) integration, therefore, can be indeed applied to explain the series of events that followed the eruption of the crisis. The only LI account of crisis management to date[81], however, assigns too much credit to the chicken game, which might not be the best fit to these events. By placing the first round of Greek rescue in the focus of analysis, the present paper tried to argue that the war-of-attrition model is better suited to depict the situation than the chicken game.

War-of-attrition is a step-by-step game; it is the timing of actions what really matters. In the chicken game, both parties know that they are heading towards a catastrophe (DD) that they both try to avoid by making the other yield. War-of-attrition, on the other hand, is more about how an agreement (CC) can be enforced in the end by minimizing the costs of engagement.

In the chicken game, the winner takes it all (DC). In a waiting game, the winner's payoff also exceeds the loser's payoff, but the payoffs to both parties do deteriorate over time. This is exactly what happened in the first phase of the Greek rescue negotiations. On the one hand, Greece tried to demonstrate its ability to cope with the crisis and to avoid default or leaving the Euro-zone. It took almost half a year for the *Papandreou* government to officially ask for (and accept) the financial assistance of the EU and the IMF. Right from the beginning, it was clear to Greek politicians that any official rescue would be granted on a conditional basis only, making the agreement politically risky. They turned to the EU/IMF at the point where the cost of additional waiting would have been unacceptable, because in that case Greece would have found itself in a disorderly default, which was the worst case scenario.

80 According to the Greek finance minister, "The problem has taken on huge dimensions. The fire risked extending not only to Greece but to the eurozone and beyond... The cost of extinguishing it is very high, and it's very high for Greek citizens.", *The Guardian*, May 2nd, 2010).

81 Schimmelfennig, F., loc. cit.

On the other hand, the EU, dominated by Germany, was obviously aware of the Greek situation, but it did not want to commit itself to an early rescue with soft conditionalities. At that point, waiting was still less costly than striking a deal. By delaying the agreement and playing tough with Greece, Germany managed to lock Greece in an agreement with strict conditionalities that met the preferences of the German public. Germany's concern was not Greece itself but the stability of the Euro-zone and the integrity of the single market. Germany decided to sign the agreement only when the conditions deteriorated considerably throughout the Euro-zone, following the downgrading of Greek sovereign bonds to junk status in late April. By that point it became evident that it was not rational to wait any longer.